

INFORMATION PAPER

SUBJ: TAX HOME FOR TWO CREW SUBMARINES, DEPLOYED STAFF AND
AIR WING PERSONNEL

Overview: The Internal Revenue Code permits a taxpayer with a place of employment different from their tax home to take certain employee business deductions in particular circumstances. Two situations that potentially impact and benefit Naval personnel are commonly misunderstood and erroneously applied. These situations relate to 1) crews of two-crew ballistic missile submarines, and 2) members of deployed staffs and air wings who are not considered permanently assigned to the embarked ship. These two situations are related but involve different tax treatment. I will refer to them in this paper as the FBM Deduction and Deployed Staff Deduction respectively. These rules are rather specific in their intended application under the law but are not always applied correctly by the Navy taxpayer. This paper will attempt to shed light on these deductions.

Discussion: Let's start with the basics. Section 162(a)(2) of the Internal Revenue Code allows the deduction of amounts expended for meals and lodging as a business expense only while the taxpayer is traveling "away from home in the pursuit of a trade or business." The general rule is that a taxpayer's "home" for business expense purposes is located at his principal place of business or regular post of duty. The IRS and Tax Court have concluded that for Naval personnel assigned to a ship or submarine, their tax home is that ship or submarine, and not where their family resides. This tax home determination is the basis for both the FBM and Deployed Staff deductions but from this point they differ as to what qualifies as a deductible expense.

1. FBM Deduction. The two-crew SSBN system permits a more expansive tax deduction potential than does the Deployed Staff Deduction. Since the submarine has been determined to be the taxpayer's tax home by IRS¹, when the other crew takes the boat out the Sailor is in the unique situation of having his tax home leave him behind rather than the usual TAD scenario. The Sailor is away from his tax home by virtue of the other crew's deployment.

During the past year the IRS became actively engaged with challenging aspects of the FBM Deduction much to the surprise of all of us who follow Navy tax matters (okay, me). An IRS Service Center took a literal reading of the original 1967 Revenue Ruling and asserted that the deduction was only available to submarine officers, not enlisted personnel. Thanks to a very proactive effort of Navy legal assistance attorneys and the IRS Taxpayer Advocate, IRS Chief Counsel came out with an updated opinion that firmly states that enlisted personnel are also entitled to the FBM deduction.²

¹ For those who are interested, see the following Ruling and case: Revenue Ruling 67-438, 1967-2 C.B. 82; *Griffin v. Commissioner*, T.C. Memo 1992-186.

² Chief Counsel Memorandum Number 200750017, Release Date: 12/14/2007; <http://www.irs.gov/pub/irs-wd/0750017.pdf> [Written by former Navy JAG Tax Lady, LCDR Donna Crisalli, JAGC, USN (Ret.)!]

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How does the FBM Deduction work? Using IRS Form 2106, a Sailor can pro-rate certain expenses incurred during off-crew periods including commuting expenses to the “temporary” duty station, 50% of the standard meal allowance (\$39 per day in 2007), and their portion of household living expenses. These deductions are only applicable during off-crew, non-leave periods. The qualifying time is generally documented by a memo from the CO or his designee. The qualifying time is a critical component of the deduction calculations.

The Form 2106 deductions are then carried over to Schedule A of Form 1040 and are incorporated into miscellaneous deductions on Line 20 of Schedule A. Note well that those who cannot otherwise itemize their deductions will not benefit from the FBM expense deduction. For those who can itemize, only the total miscellaneous expense amount that exceeds 2% of their adjusted gross income will be deductible. For example, let’s assume total 2106 and other expenses of \$2400 and an adjusted gross income of \$40,000. Only the expenses that exceed \$800 (2% of \$40,000) will be deductible, leaving the taxpayer with, in this case, \$1600 of miscellaneous deductions. Not bad but not going to make you dance to the bank.

Sailors who may qualify for the FBM Deduction are often referred to some privately operated web sites that provide “assistance” with the calculations and have worksheets for Sailors to use. While I have no reason to believe these web sites are malicious or provide information that will cause Sailors to violate tax law, they are not run by tax professionals nor sanctioned by the IRS. The old adage GIGO – Garbage In, Garbage Out – should be borne in mind. Use any non-official information at your own risk!

Further, as discussed above, there has been recent IRS scrutiny regarding the FBM Deduction. While we had a favorable outcome on the eligibility issue, it appears that this deduction is now on the IRS radar (or should I say sonar?) and further scrutiny of actual deductions may be possible. Another old axiom comes to mind, “pigs get fat, but hogs get slaughtered.” Despite my sojourn in Nebraska I am not quite sure of the origin of this one, but in the tax world it is taken to mean that you can be a bit “aggressive” on your taxes, but if you go too far, you will get in trouble. If you are entitled to the FBM Deduction, by all means take full advantage of it. Document your days accurately, get it validated by your CO, keep track of your mileage and expenses, etc. If you stay within bounds, you will withstand scrutiny. If you don’t, not only will you be penalized, but you might bring undesired attention to your fellow boomer Sailors who, I imagine, will not be real happy about that!

2. Deployed Staff Deduction. Officers who are not permanently assigned to a ship but embark thereon for a cruise can qualify for a limited deduction since the ship is not considered their tax home. Officers assigned to staffs that are permanently embarked do not qualify for the Deployed Staff Deduction as they are considered embarked on their tax home.

Unlike the FBM deduction, those taxpayers on a deployed staff or air wing who qualify for the Deployed Staff Deduction are limited as to the expenses that can be deducted. Essentially the only deductible item is meal expenses for those who have to pay for their on-board meals since the Navy is providing them with lodging and transportation at no additional cost. While many members of deployed staffs or air wings believe that they can use the entire per diem amount as the basis for the expense deduction, it is only the meals and incidental expenses (M&IE) portion that can be used, with the further limitation that only 50% of the meal costs are allowed under

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the law, with special pro-ration rules for days of departure and return. While the law permits a taxpayer to use the standard M&IE amount in lieu of maintaining adequate daily meal records, this practice is extremely difficult to justify for a Naval officer who must pay his or her mess bill on a monthly or other regular basis. Since there are easily ascertainable records of meal expenses during a cruise, use of the standard meal rates may not pass IRS audit scrutiny. If you elect to use the standard rates, the applicable per diem (M&IE) amounts in CONUS can be found at <http://perdiem.hqda.pentagon.mil/perdiem/pdrates.html> (DoD specific), while overseas rates are available at that site or at the State Department site, http://aoprals.state.gov/content.asp?content_id=184&menu_id=78.

Further, since officers are given a monthly meal allowance (BAS), this amount must be deducted from the monthly meal expense cost. As above, the expense amount is reported on Form 2106 or 2106EZ and is available only to those who can itemize their deductions and then only to the extent that the expenses exceed 2% of adjusted gross income. Common problem areas are misapplication of the rules to include mythical lodging expenses for the time at sea and failure to deduct meal allowances provided by the Navy from the meal expense. Another common question is whether the expense of on-shore lodging during a port call (an “admin” in my day) qualifies for the lodging expense deduction. The short answer is no, since the Navy is still providing you on board lodging but you elect to move on shore to take advantage of the hotel amenities. Too bad, this is more in the nature of a non-deductible vacation! Finally, a Sailor who is not paying for his meals at sea is not entitled to this deduction whereas those paying mess bills can take advantage of it. I recommend preparing a breakdown of deployment time and having it certified by someone on the Staff or Air Wing in case you are ever audited. And, as noted above, use of actual expenses vice standard expenses is highly recommended to minimize the opportunity for unwanted scrutiny and unfortunate results.

No “Mariner’s Deduction.” As reported recently in Tax Information Memorandum 01-08, there is a tax scam circulating that may confuse afloat Sailors, particularly given the discussion above about the Deployed Staff Deduction. The assertion here is that a taxpayer who is employed on board a ship that provides meals at no cost to the taxpayer as part of the employment may deduct from gross income the cost of the meals as an employee business expense. I can hear the gears turning already. I’m a Sailor stationed on a ship as part of my employment with the Navy. I get meals provided by the ship at no cost as part of my employment. Hmm, that sounds like I qualify for this “Mariner’s Tax Deduction.” Well, you would, except that there is NO SUCH DEDUCTION! See TIM 01-08 for more information.

Conclusion: As I hope is clear from the foregoing, the tax home business expense deduction is a legitimate method to use the Tax Code to reduce your tax bill **IF** you properly apply the rules. The rules apply to a very limited number of Navy personnel and require significant scrutiny to ensure compliance with the actual rules and not the scuttlebutt passed around out in the Fleet. Done correctly, you have a tax benefit. Misapply the rules or pad your expenses and you are risking a comprehensive tax audit and probable penalties and interest. Even with a kinder gentler IRS this is not a pleasant experience! Contact the Navy Tax Counsel at Code 16 if you need clarification or have any questions. You can reach me at DSN 325-4639; 4642, Comm: (202) 685-4639; 4642); fax DSN 325-5486, (202) 685-5486, or e-mail [George.Reilly@navy.mil].